

Pooled Investment Vehicles Reference

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

GENERAL ADMINISTRATION

- 1 Assess the planning and risk analysis of any new pooled investment vehicles that have begun operations since the last examination.
- 2 If any pooled investment vehicles have been terminated or become inactive since the last examination, evaluate management's planning and risk analysis supporting such actions.
- 3 Evaluate the adequacy of written policies and procedures for the administration of pooled investment vehicles.
- 4 Determine if the institution maintains, where required, a copy of the governing plans for pooled investment vehicles, together with any revisions or amendments.
- 5 Determine if each pooled investment vehicle has had a periodic and independent investment and administrative review.
- 6 Determine if accurate and complete subsidiary and control ledgers are maintained for assets and participants.
- 7 Determine if periodic court accountings are prepared when necessary.
- 8 Determine if an IRS "determination letter" is maintained for pooled investment vehicles exempt from federal taxation.

Performance

- 9 Determine if management periodically evaluates the performance of pooled investment vehicles and compares performance to representative benchmarks.
- 10 Determine if management initiates action to correct poor performance.
- 11 Determine whether pooled investment vehicles are managed in a manner consistent with their stated investment objectives.
- 12 Determine if pooled investment vehicles are managed to meet liquidity needs.
- 13 Determine if the expenses of operating pooled investment vehicles are reasonable, authorized and, when so governed, within any limitations imposed by the plan document.

COMMON TRUST FUNDS

IRC Section 584 - Exemption from Federal Income Tax [Note: Section 584 requires compliance with OCC Regulation 9.18 to qualify for tax-exempt status]

- 14 Determine that only accounts in which the trust department acts in the capacity of trustee, executor, administrator, or guardian are permitted to invest in CTFs .

OCC Regulation 9.18-Audit

- 15 Determine if CTFs are audited at least once during each 12-month period. [OCC 9.18(b)(6)(i)]
- 16 Determine if auditors report directly and independently to the bank's board of directors. [OCC 9.18(b)(6)(i)]
- 17 Determine if at least once during each 12-month period financial reports based on audits are prepared. [OCC 9.18(b)(6)(ii)]
- 18 Determine if financial reports contain the following: [OCC 9.18(b)(6)(ii), (A), (B), (C), and (D)]
- 18 A Fees and expenses in a manner consistent with state law
 - 18 B A list of investments showing cost and current market value of each investment
 - 18 C Investment changes for the period reflecting purchases (with costs) and sales (with profit or loss)
 - 18 D Income and disbursements since the last report
 - 18 E Notation of any defaulted securities
- 19 Determine if financial reports refrain from making predictions or representations as to the future performance of funds. [OCC 9.18(b)(6)(iii)]
- 20 Determine if financial reports refrain from publishing the performance of funds not administered by the bank or its affiliates. [OCC 9.18(b)(6)(iii)]
- 21 Determine if financial reports are made available at no charge to persons participating in CTFs. [OCC 9.18(b)(6)(iv)] (Note: Management may provide a copy of the report to any other person for a reasonable fee.)

OCC Regulation 9.18-Governing Document

- 22 Determine if funds are governed by a written trust agreement, plan, declaration of trust, or group trust. (Note: A plan may cover multiple funds).
- 23 Determine if funds are approved by the institution's board of directors or designated committee. [OCC 9.18(b)(1)]
- 24 Determine if governing plans contain the following provisions: [OCC 9.18(b)(1)(i) through (xi)]
- 24 A Investment powers and policies with respect to the fund.
 - 24 B Allocation of income, profits, and losses.
 - 24 C Fees and expenses that will be charged to the fund and to participating accounts.
 - 24 D Terms and conditions governing the admission and withdrawal of participating accounts.

- 24 E Audits of participating accounts.
 - 24 F Basis and method of valuing assets in the fund.
 - 24 G Expected frequency for income distribution to participating accounts.
 - 24 H Minimum frequency for valuation of fund assets. (Note: Should not be valued less frequently than quarterly)[OCC 9.18(b)(4)(i)]
 - 24 I Amount of time following a valuation date during which the valuation must be made.
 - 24 J Conditions under which the bank may terminate the fund.
 - 24 K Any other matters necessary to define clearly the rights of participating accounts.
- 25 Determine if a copy of the governing plan is made available to any person for inspection at the main office of the bank during banking hours. [OCC 9.18(b)(1)]

OCC Regulation 9.18-Operational Rules

- 26 If management of a fund has been delegated to an outside investment advisor, determine that the delegation is prudent. Consider the following:
- 26 A Delegation is permitted under governing law.
 - 26 B The arrangement is governed by a written agreement.
 - 26 C The advisor performs only the functions the bank could perform.
 - 26 D The trustee bank establishes specific investment guidelines to be followed by the investment advisor.
 - 26 E The trustee bank reviews the investment advisor's activities.
 - 26 F The trustee bank can terminate the contractual relationship at will.
- 27 Determine if each account participating in a fund represents a proportionate interest in the fund's assets. [OCC 9.18(b)(3)]

OCC Regulation 9.18-Admissions and Withdrawals

- 28 Determine if investments are valued at market value whenever admissions or withdrawals to a CTF take place. [OCC 9.18(b)(4)]
- 29 Determine if purchases and sales of units are allowed only on a valuation date and only after receiving appropriate approval. [OCC 9.18(b)(5)(i) and (ii)]
- 30 Determine if the prior notification period for withdrawals does not exceed one year. [OCC 9.18(b)(5)(iii)]
- 31 Determine if distributions to accounts withdrawing from CTFs are made in cash, ratably in kind, a combination of cash and ratably in kind or in any other manner consistent with state law. [OCC 9.18(b)(5)(iv)]
- 32 Determine if short-term investment funds valued at cost:

32 A Maintain a dollar weighted average portfolio maturity of 90 days or less. [OCC 9.18(b)(4)]

32 B Accrue on a straight-line basis the difference between cost and anticipated principal receipt at maturity. [OCC 9.18(b)(4)]

32 C Hold assets until maturity under usual circumstances. [OCC 9.18(b)(4)]

33 Verify that, where market values are not readily ascertainable, management uses fair values determined in good faith. [OCC 9.18(b)(4)(ii)(A)]

34 Determine if management values guaranteed investment contracts in compliance with AICPA Statement of Position #94-4. [OCC 9.18(b)(4)(ii)(A)]

OCC Regulation 9.18-Advertising

35 Determine that the bank refrains from advertising CTFs, except in connection with the advertisement of general fiduciary services. [OCC 9.18(b) (7)]

OCC Regulation 9.18-Conflicts of Interest

36 Determine that the bank does not have any interest in the fund other than in its fiduciary capacity. [OCC 9.18(b)(8)(i)] (Note: This provision prohibits a fund from purchasing bank or affiliate assets or obligations)

37 Determine that the bank does not make any loans secured by the participant's interest in the fund. [OCC 9.18(b)(8)(ii)]

38 If the institution purchases an investment in default from a fund, determine that the purchase is at market value or the sum of cost and accrued unpaid interest, whichever is greater. [OCC 9.18(b)(8)(iii)]

39 Determine if fees and disclosures comply with state law. [OCC 9.18(b)(9)(i)]

40 Determine if fees are reasonable. [OCC 9.18(b)(9)(ii)]

41 Determine if expenses charged to funds are reasonable and allowable under state law. [OCC 9.18(b)(10)]

42 Determine that management refrains from issuing any certificate or other document to evidence a direct or indirect interest in a fund, except to provide a withdrawing account an interest in a segregated investment. [OCC 9.18(b)(11)]

Exemption from Securities Laws

43 Review funds for ineligible participants. Consider the following:

43 A Only accounts in which the trust department acts in the capacity of trustee, executor, administrator, or guardian are permitted to invest in CTFs.

43 B Agency and IRA accounts are prohibited from investing in funds. [Securities Act of 1933, Section 5 Prohibitions relating to interstate commerce and mails and Investment Company Act of 1940, Section 7 - Transactions by unregistered investment companies] (Note: For Keogh plans, refer to the procedures under the Collective Investment Fund section.)

44 Determine if management prohibits commingling personal trust and employee-benefit accounts in CTFs. [Investment Company Act of 1940, Section 3(c)(11)]

Reporting Requirements

45 Determine that management complies with U.S. Treasury Regulation Section 1.6032.1 and IRC 6032. Consider the following requirements:

45 A Annual informational returns should be filed with the IRS. (Note: Although not required, Schedule K-1 of Form 1065 is typically used to satisfy this reporting requirement.)

45 B Annual informational filings for each fund should contain information on fund participants, including name, address, and proportional share of taxable income or losses and capital gains or losses.

45 C A full copy of the declaration of trust, group trust, trust agreement or plan should be submitted to the IRS at least once.

COLLECTIVE INVESTMENT FUNDS (CIF)

IRS Revenue Ruling 81-100 - Exemption from Federal Income Tax

46 Determine if employee benefit trust or agency accounts afforded tax-exempt status through IRC 401 or 408 are the sole participants in the funds.

47 Determine if charitable trust or agency accounts are prohibited from investing in CIFs.

48 Determine if group trusts are adopted as part of each participating employee-benefit plan.

49 Determine if group trusts prohibit assets from being diverted to any purpose other than the exclusive benefit of participating plan beneficiaries. Consider the following:

49 A Group trusts prohibit assignment of any asset by any of the participating plans.

49 B Group trusts are established and maintained as domestic U.S. trusts.

Exemption from Securities Laws

50 Review funds for ineligible participants.

50 A Determine if employee benefit trust and agency accounts afforded tax-exempt status through IRC 401 are the sole investors in the funds. (Note: This precludes Individual Retirement Accounts granted tax-exempt status under IRC 408 from investing in the funds.)

51 Determine if management prohibits commingling personal trust and employee-benefit accounts in funds.

Keogh Accounts

52 If Keogh accounts are permitted to invest in a CIF, determine the following:

52 A Only Keogh and other accounts receiving tax exemption under IRC Section 401 are permitted to invest in the CIF, and

52 B CIFs that permit investments by Keogh accounts qualify for the exemption from securities registration because they are offered and sold only to residents within a single State or Territory and are issued by an institution doing business within such State or Territory (Intrastate Exemption) (Section 3(a) (11) of the Securities Act of 1933 Act and Section 3(c)(11)(A) of the Investment Company Act of 1940), or

52 C Plan sponsors qualify as sophisticated investors, as defined in SEC Rule 180.

Government Plans

53 If government employee benefit plans are invested in CIFs, determine if the funds are exempt from registration as a security and as an investment company under the following:

53 A Internal Revenue Code sections 401, 403, 414(d), or 457

53 B Securities Act of 1933 Act section 3(a)(2)(C)

53 C Securities Exchange Act of 1934 Act section 3(a)(12)(C)(iii)

53 D Investment Company Act of 1940 Act sections 3(c)(11)(A) and (B)

OCC Regulation 9.18

54 Determine if collective investment funds are operated in accordance with OCC 9.18(b) or comparable standards. [Note: Unless state law requires compliance with OCC 9.18, failure to operate CIFs in accordance with OCC 9.18(b) or comparable standards should not be scheduled as violations, but, instead, should be discussed as appropriate in examination comments.]

COMMON TRUST FUNDS AND COLLECTIVE INVESTMENT FUNDS OF OTHER INSTITUTIONS

55 Determine if the institution invests in the CTFs and CIFs of other affiliated institutions. (Refer to 1989 SEC No-Action Letter to Old Kent Financial Corporation.)

56 Determine if investments in funds of affiliated banks are permitted under state law.

57 Determine if the plan or governing document authorizes investment in funds of affiliates.

58 Determine if the board of the affiliated bank has authorized the use of the originating bank's plan.

59 Determine if the affiliated bank maintains documentation for all admission and withdrawal decisions for each fiduciary account invested in the originating bank's fund.

60 Determine if the originating bank is notified on or before the fund valuation date, and that the appropriate committee of the originating bank approves all admissions to and withdrawals from funds operated by affiliated institutions.

61 Determine if the originating bank furnishes the annual financial report of the affiliated institution's fund(s), or notice of its availability, to each fiduciary account invested in its fund.

62 Determine that the institution refrains from investing the assets of fiduciary accounts in CTFs or CIFs of non-affiliated institutions.

CONVERSIONS TO PROPRIETARY MUTUAL FUNDS

- 63 Determine that any conversions since the previous examination complied with applicable state and federal laws.
- 64 Determine that management provided adequate disclosures and obtained positive written consents from account holders or beneficiaries.
- 65 Determine that management obtained the advice of legal counsel.
- 66 Determine if the institution notified state regulatory authorities prior to conversion, if applicable.
- 67 Determine if management adequately documented that the decision to convert was in the best interest of the account holders.
- 68 Determine if management performed a comprehensive risk analysis. Consider the following:
- 68 A Legal risk.
 - 68 B Tax consequences. [Note: For CTFs tax-free conversion must comply with IRC 584(h).]
 - 68 C Potential benefits and costs.
 - 68 D Conflicts of interest.
 - 68 E Suitability.
 - 68 F Permissibility under the governing instruments.
 - 68 G Conversion mechanics. (cash or in-kind transfer)
 - 68 H Client communication.
 - 68 I Account treatment for customers that do not provide consent or are disallowed under the governing instrument from investing in the mutual fund.
 - 68 J Fund selection.
 - 68 K Post conversion operations including proxy voting and ongoing investment reviews.
 - 68 L Fee arrangements, including any offsets and rebates.
- 69 Determine if the basis for mutual fund shares distributed to participant accounts was equal to the basis of the CTF or CIF interest exchanged.
- 70 Determine if fiduciary fees and mutual fund servicing fees are reasonable and consistent with industry standards, governing instruments, and applicable law.
- 71 Determine if management provided a copy of the prospectus to participating accounts prior to conversion.
- 72 Determine if the board of directors approved the conversion.

73 Determine that transactions involving the conversion of CTFs or CIFs to proprietary mutual funds were exempt from the prohibited transaction restrictions of Section 406 of ERISA and the taxes imposed by IRC 4975. Consider the following requirements:

73 A For in-kind transfers, determine whether the requirements of PTE 97-41 were satisfied:

73 A1 The plan did not pay a sales commission in connection with the transaction.

73 A2 Transferred assets consisted solely of securities for which market quotations were readily available.

73 A3 An independent fiduciary was given advance comprehensive information on the transaction, including the following:

73 A3A A current prospectus for each mutual fund to which the CIF's assets were transferred.

73 A3B A description of any fee arrangements between the bank, the mutual fund and the plan.

73 A3C The reasons why the exchange of investment was appropriate for the plan.

73 A4 An independent fiduciary gave prior written approval of the transaction.

73 B In cash-to-cash conversions, determine if management complied with PTE 77-4. (Refer to procedures in Proprietary Mutual Funds section of this module.)

MUTUAL FUNDS

74 Evaluate management's due diligence in selecting mutual funds and mutual fund companies.

75 Determine if management periodically reviews mutual fund performance and compares the performance to representative indices or other mutual funds with similar objectives.

Servicing and Fee Arrangements

76 Review service contracts between the institution and the investment companies. Determine if management's practices comply with the contract.

77 Determine if management takes the following steps prior to entering into any fee sharing arrangement with a mutual fund company: [FRB: SR99-7]

77 A Obtains a legal opinion on the permissibility of the investment and compensation.

77 B Establishes policies and procedures governing fee sharing arrangements

77 C Documents the decision making process by which the suitability and prudence of the arrangement was established.

78 Determine that any fees collected from mutual funds are:

78 A In compliance with state law.

78 B Reasonable.

78 C Sufficiently disclosed. (Note: May be disclosed in the fund's prospectus)

79 Determine if the institution in its capacity as fiduciary for employee-benefit accounts refrains from collecting 12b-1, shareholder servicing or other similar fees from mutual fund companies [ERISA 406(b)(1) and (b)(3) and IRC 4975 (prohibited transactions)] unless:

79 A The fees are offset or rebated back to the account. [AO 97-15A (Frost)]

79 B The bank has no investment discretion. [AO 97-16A (Aetna)]

Proprietary Mutual Funds

80 Determine that investments in the institution's proprietary mutual fund(s) comply with applicable laws including the following:

80 A Federal Reserve Act Section 23B.

80 B State law.

81 Determine if employee benefit plans that invest in proprietary mutual funds comply with the following requirements: [ERISA 406 and PTE 77-4]

81 A The plans do not pay a sales commission in connection with the transaction.

81 B The plans do not pay a redemption fee unless:

81 B1 The fee is paid only to the investment company

81 B2 The fee is disclosed in the prospectus

81 C The institution does not collect investment management or investment advisory fees at both the fund level and the plan level, which would be considered "double dipping."

81 D An independent fiduciary is given advance comprehensive information on the transaction including the following:

81 D1 A current prospectus for each fund to which the CIF's assets may be transferred.

81 D2 A description of any fee arrangements between the bank, the fund and the plan.

81 D3 The reasons why the investment is appropriate to the plan.

81 E An independent fiduciary gives prior written approval of the transaction.

82 Determine that policies and procedures adequately address investments in proprietary mutual funds and include guidelines on applicable law, investment authority, conflicts of interest, documentation, and disclosures.

83 Determine that proprietary mutual funds earn returns that are comparable to other non-proprietary funds with similar risk characteristics.

83 A If returns are not competitive, determine if management adequately documents the prudence of the decision to continue using the proprietary mutual fund.

84 Determine that a copy of the CIF or CTF's annual report, together with the requisite certification, has been provided to the plan administrators of the participating accounts. [DOL 2520.103-5(c)(2)(i) and (d)]

85 Determine that any transactions between participating plans and the funds are exempt from the prohibitions of ERISA 406. [ERISA 408(b)(8) and IRC 4975(d)(8)] Consider the following requirements:

85 A The transaction is a sale or purchase of an interest in the fund.

85 B The bank receives not more than reasonable compensation.

85 C The plan or an independent fiduciary expressly permits the transactions.

86 Determine that any transactions between the fund and a "party in interest" are exempt from the prohibitions of ERISA Section 406(a). Refer to the PTE 91-38. [Note: Transactions between the fund and a fiduciary are not exempt and must comply with ERISA Section 406(b).]

OTHER POOLING ARRANGEMENTS

87 If the institution operates any pooled investment funds that are exempt from securities registration under SEC Regulation D, determine whether all requirements for the exemption have been and continue to be satisfied.